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No. 81-523

IN THE
SUPREME COURT OF THE UNITED STATES
OCTOBER TERM, 1981

CONTAINER CORPORATION OF AMERICA,

Appellant,

v.

FRANCHISE TAX BOARD,

Appellee.

On Appeal From The Court of Appeal
of the State of California
for the First Appellate District

MOTION OF EMI, LIMITED FOR LEAVE TO FILE BRIEF AMICUS CURIAE

AND

BRIEF AMICUS CURIAE IN SUPPORT OF APPELLANT'S JURISDICTIONAL STATEMENT

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EMI, Limited, hereby respectfully moves for leave to file the accompanying brief as amicus curiae in this case. The consent of the attorney for the Appellant has been obtained. The consent of the attorney for the Appellee has been sought, but has neither been given nor denied.

EMI, Limited (hereinafter EMI), is a United Kingdom corporation, which does not have a permanent establishment in the United States, under the United States-United Kingdom Tax Convention, and which does not do business in the United States. EMI has subsidiaries which operate in more than 40 countries other than the United Kingdom, including the United States. Many of the corporations which operate in countries foreign to the United Kingdom are in the business of recording music or manufacturing and selling recorded music, principally on record disk, but also on tape or cassette. EMI has a United States subsidiary, Capitol Industries-EMI, Inc., which in turn has a subsidiary domiciled in Los Angeles, California, which records music, manufactures records, and sells records at wholesale. Capitol Industries-EMI, Inc., has filed California Franchise Tax returns of income, reporting its income on the unitary basis, combining

its operation inside of California with those outside of it, including those of its subsidiaries. It has not filed its California Franchise Tax return income combining itself with its parent corporation, EMI, or EMI's other subsidiaries. The California Franchise Tax Board has administratively combined Capitol Industries-EMI with EMI and its other subsidiaries, on a "music only" basis.

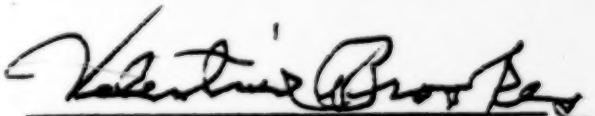
EMI has brought an action for an injunction in declaratory relief in the federal courts, and its case is on appeal to the Ninth Circuit Court of Appeals under the style EMI, Limited v. Bennett, et al., No. 80-4114. Capitol Industries-EMI, Inc. has also brought suit in the federal courts, and in a companion case its appeal is before the Ninth Circuit Court of Appeals under the style Capitol Industries-EMI, Inc. v. Bennett, et al., No. 80-4113. The two cases have been consolidated for oral argument, which is scheduled for October 15, 1981.

A principal contention of both EMI, Ltd., and Capitol Industries-EMI, Inc., is that the unitary combination which California seeks to impose on the two companies is an imposition on and attempted regulation of foreign commerce, and is barred by the United States Constitution, Article I, Sec. 8, cl. 3, as interpreted in this Court in Japan Line, Ltd. v. County of Los Angeles, 441 US 434 (1979).

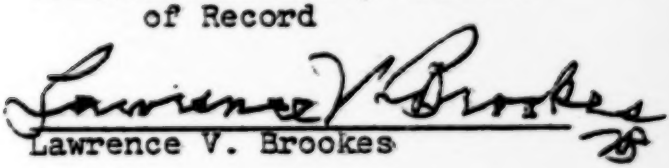
While there may be constitutional limitations against state taxation of the income of a United Kingdom corporation not having a permanent establishment in the United States not presented in the case at bar, the Court's review of

this case and reversal of the California decision may well dispose of EMI's case as well as the case at bar.

Respectfully submitted,



Valentine Brookes, Counsel
of Record



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INTEREST OF THE AMICUS

The interest of Amicus EMI, Limited, is set out in the accompanying motion of EMI, Limited for leave to file this brief as amicus curiae.

THE QUESTION PRESENTED IS SUBSTANTIAL

This case presents an important constitutional issue with respect to the imposition by the various states of their income taxes on income earned in foreign commerce by related corporations, which is apportioned by formula in a unitary combination, to the taxing state, and there taxed, when the income already has been subjected to tax in the country where earned. The case presents the issue whether the standards set forth in Japan Line, Ltd. v. County of Los Angeles, dealing with state taxation of foreign commerce, apply to income taxation as well as to property taxation.

I. THE DECISION IN JAPAN LINE, LTD. v. COUNTY OF LOS ANGELES, 441 US 434 (1979), CONTROLS THIS CASE.

The effect of the Supreme Court decision in Japan Line, Ltd. v. County of Los Angeles, 441 US 434 (1979) is to invalidate California's taxing an apportioned share of the foreign

income of Container Corporation's foreign subsidiaries, income which was fully taxed by the host countries with a resulting duplicating international taxation which violates the Foreign Commerce Clause. The Japan Line case involved the effort of Los Angeles County to impose an apportioned property tax on containers owned by a Japanese steamship company which Japan had taxed at their full value, and the effect of the California tax was to impose a multiple burden on the machinery of foreign commerce. The California Supreme Court has sustained the tax. This Court held it unconstitutional. The same considerations apply here.

The bases of the decision were tripartite: First, the United States must speak with a single voice in foreign matters, and therefore the states cannot be permitted to intrude on the area; second, the theory of apportionment is workable when dealing with interstate commerce because the United States Supreme

Court has the power to enforce apportionment among all of the taxing parties involved, but in foreign commerce the United States Supreme Court is powerless to enforce apportionment on the foreign country which has the right to impose a tax on the full value of the property; and third, to permit any state by an asymmetric taxing method to impose multiple burdens on foreign commerce would invite retaliation by the foreign countries, and the retaliation would be against all 50 of the United States, and not merely against the offending state.

The Court below held that this Ccurt's decision is inapplicable here, where the tax is not a property tax. That contention will not survive analysis, or even a critical reading of this Court's opinion.

Analysis of the three prongs on which the Japan Line decision is based shows that each of them applies to taxes on or measured by net income, as much as to property taxes.

There can be no logical justification for imposing the single-voice doctrine on state property taxes and exempting from it state income taxes. We doubt that anyone can even suggest a reason for permitting the United States to speak with fifty voices where income taxes are involved but for requiring a single voice only where property taxes are involved. Indeed, the doctrine is not confined to taxes, but extends to all areas of possible state legislation. A century ago it was applied to invalidate a California law requiring bonds of Chinese immigrants. See Chy Lung v. Freeman 92 US 275 (1876), cited in footnote 16 of Japan Line. The phrase "one voice" appears to have originated in Mr. Justice Frankfurter's concurring opinion in United States v. Pink 315 US 203, 242 (1942), where the opinion for the Court used the phrase "sole organ" in speaking of the Executive's power. 315 US 203, 223, 229. In Pink an executive agreement was held

effective to override New York law and public policy determining ownership of property.

The second prong of the decision was that the United States lacks power to compel foreign countries to refrain from taxing the entire value of property over which they have taxing jurisdiction, and instead to adopt the apportionment principle. That lack of power to compel international apportionment also exists for a tax on or measured by net income.

The third prong of the decision was that to permit California to adopt any asymmetric method of taxing when the method produced multiple taxation would inevitably invite retaliation by foreign countries. California has adopted an asymmetric income tax system. The possibility of retaliation for multiplication of tax burden is greater for an income tax than for a property tax. The community of nations has exhibited far more concern with duplicating income taxes than

with duplicating property taxes. The extensive system of bilateral tax treaties deals with income taxes, and rarely with property taxes except for the blanket nondiscriminatory clauses. The United States is a party to 35 income tax treaties, plus five which at last count had been signed but not ratified. If the California tax violates those treaties they may be renounced by the foreign signatories and retaliatory measures substituted. If that should occur, as the Supreme Court pointed out in Japan Line, the retaliation will be against the entire 50 states, not merely against the one which provoked it.

The Japan Line opinion contains ample evidence, affirmative in nature, that this Court did not intend to confine its decision to property taxes. The structure of the opinion as well as the language shows the Court intended to enunciate principles applicable to all types of state taxes, as well as to

the case before it. Thus, in Part B of the opinion (441 US 434, 444) the Court stated the principles limiting all state taxation of foreign commerce, and in Part C (441 US 434, 451) applied them to the particular tax before it and demonstrated why the tax was inconsistent with those principles.

The discussion of the governing principles made no distinction at all between kinds of taxes. This Court distinguished Complete Auto Transit v. Brady, 430 US 274 (1977), and Washington Revenue Department v. Stevedoring Association, 435 US 734 (1978), on the ground that they involved interstate commerce instead of foreign commerce. The first case involved a privilege tax measured by gross sales or gross income, and the second one involved an occupation privilege tax measured by gross income. This Court did not distinguish them because they were not property tax cases but instead recognized that they would have had relevance if the tax before it had involved

interstate commerce instead of foreign commerce. (441 US 434 at p. 455) In considering the effect of multiple taxation on foreign commerce, the first case cited in the Japan Line opinion was Evco v. Jones, 409 US 91 (1972), which involved a state sales tax. The opinion also cited J. D. Adams Manufacturing Co. v. Storen, 304 US 307 (1938), which involved a state gross income tax. It was from this line of cases, involving sales taxes and gross income taxes, that this Court evolved the doctrine that apportionment among taxing jurisdictions was necessary to preserve the validity of taxes on instrumentalities of interstate commerce. This was the foundation for its consideration of the question whether apportionment such as California had invoked was sufficient to save the tax when it was on an instrumentality of foreign commerce, instead of interstate commerce. The opinion quoted language from Washington Revenue Department, involving an occupation privilege

tax measured by gross income, and Evco v. Jones, involving a state sales tax, and the latter quoted language from J.D. Adams Manufacturing Co., which involved a gross income tax. This Court could not have thought these cases relevant only to property taxes.

In addressing the question whether a different rule should apply in foreign commerce than in interstate commerce, this Court declared that a state tax on foreign commerce could impair federal uniformity in an area where federal uniformity is essential. The opinion quoted (441 US 424, 448):

> "Foreign commerce is eminently a matter of national concern. 'In international relations and with respect to foreign intercourse and trade, the people of the United States act through a single government with unified and adequate national power.'"

from Board of Trustees v. United States, 289 US 48 (1933), which was an import duty case, not a property tax case. It was the opinion stated next that in a foreign commerce context (441 US 434, 451):

> "... a court must ... inquire, first, whether the tax, notwithstanding apportionment, creates a substantial risk of international multiple taxation, and second, whether the tax prevents the Federal Government from 'speaking with one voice when regulating commercial relations with foreign governments.' If a state tax contravenes either of these precepts it is unconstitutional under the Commerce Clause." (Emphasis added)

It is clear that the Court meant: "If any state tax contravenes," etc.; and not merely: "If a state property tax contravenes," etc.

The Japan Line opinion emphasized the necessity of speaking with one voice in regulating foreign trade. The Court explained that the single voice doctrine required uniformity of treatment by each state of the United States, so that foreign commerce would not be subject to "varying degrees of multiple taxation" depending on the state in which it happened to arrive (441 US 434, 453). It pointed out that the asymmetry of California's tax prevented uniformity. The same is true

with California's franchise tax. California stands almost alone in its methods. There can be no rational basis for permitting "varying degrees of multiple (income) taxation" but frowning on "varying degrees of multiple (property) taxation."

Finally, the Court rejected the County's contention that Moorman Manufacturing Co. v. Bair, 437 US 267 (1978) permitted multiple taxation by stating (441 US 434, 456):

> "...Moorman finally, concerned interstate commerce. This case concerns foreign commerce."

The Court did not distinguish the Moorman case because it was an income tax case.

The Court also spoke of international disputes which would occur over reconciling apportionment formulae, if the states were allowed to impose an apportioned tax. 441 US 434, 448. This concern cannot possibly be less if the apportioned tax is on income instead of tangible property.

In Mobil Oil Corp. v. Commissioner of Taxes,

445 US 425 (1980), this Court considered whether Japan Line established principles applicable to a State net income tax. Part B of the prevailing opinion is entirely devoted to discussing the possible application of the Japan Line case to the Mobil Oil case, and the seven paragraphs of that Part could have been reduced to one if the Court meant that Japan Line was inapplicable because it involved a property tax. The Court distinguished Japan Line by stating (445 US at 448):

> "Japan Line, moreover, focused on problems of duplicating taxation at the international level, while appellant here has confined its argument to the wholly different sphere of multiple taxation among our States."

The international community has evidenced much greater concern with the burgeoning effect of duplicating tax burdens through the income tax then through the property tax. The United States has signed more than forty income tax conventions with foreign countries, but no property tax conventions. Where property taxes are dealt with in international

treaties they are dealt with as an incident either to the income tax convention or to treaties of commerce and navigation.

Both the Government of the United Kingdom and the Commission of the European Economic Community have lodged formal protests with the United States State Department over the California apportionment unitary practices, and have called them a violation of international law. The letter to the Department of State from the Commission of the European Economic Community is particularly strong in demanding that the United States Government make some change to eliminate California's departure from the practice prevailing among sovereign nations, and to compel the use by California of the same system of determining source of taxable income as is used by the United States Internal Revenue Service, and by the bilateral treaties in effect. In all such treaties, the rule in effect is that the independence of the foreign subsidiary be recognized, that it be regarded as a

separate taxpayer from the parent, and that the Internal Revenue Service employ the arms-length standard to insure that the net income being reported for taxation is the same as would be produced by arms-length bargaining between the two corporations, using the same fair price standard which could be expected to be operative if the two corporations were not commonly owned. This is the system the Government of the United Kingdom and the Commission of the European Economic Community demanded that the United States Government enforce on the State of California. To date, nothing has been done to bring California into correspondence with the rest of the world.

As a practical matter, action by the United States Congress is uncertain, because the foreign governments do not have elected representatives voting in either house of the Congress. California, however, has a considerable representation in the House of Representatives and the usual allotment of Senators.

Nor do foreign corporations, by which we mean corporations with their headquarters in and most of their shareholders also in foreign countries, have a significant voice with the United States Congress. Their reliance must be on international law and the United States Constitution, and it is the United States Constitution which amicus is asking this Court to interpret.

II. THE OPINION BELOW DEMONSTRATES MINIMAL INTERCOMPANY SALES INTO OR OUT OF THE UNITED STATES, AND THEREFORE THE USE OF FORMULARY APPORTIONMENT MUST DISTORT TAXABLE INCOME, SO AS TO SUBJECT FOREIGN INCOME TO STATE TAX.

Container Corporation does not present a case where extensive inter-company transfers of raw materials product know-how permit the companies not subject to the state's tax to profit at the expense of the company (or companies) whose net income properly is subject to tax. The Court below explicitly acknowledged this. (Jurisdictional Statement, A-8 - A-9)

The record below shows that foreign workers are paid substantially less to produce the same quantity of product and that the foreign subsidiaries could be expected to be more profitable than U.S. operations (Jurisdictional Statement, pp. 18, 19), and the greater profits can not be attributed to the U.S. operations. Necessarily, the income which when added to U.S. income and apportioned is taxed in California, must have been earned in the foreign countries exclusively; California should not be permitted to tax it as the price for appellant's engaging in foreign commerce.

California has shown no concern with whether or not unusual circumstances such as those demonstrated in the Jurisdictional Statement (pp. 17-20) exist, but applies its formula rigidly in all instances in which it considers that a unitary business exists, operating in California and elsewhere in the world, whether in foreign countries or in the United States.

The typical foreign subsidiary,

exemplified by the facts of this case, will pay income taxes to the host country on its entire net income. The United States tax laws permit the parent corporation, if a consolidated return is filed, to claim a credit for the tax paid by the subsidiary to the foreign country. If a United States consolidated return is not filed, then the United States parent is taxable only on the dividends which it receives from its foreign subsidiary, and dividends are paid from net income after taxes, so the arithmetic effect is that the United States allows a deduction for taxes paid to the foreign country where no consolidated return is filed, and the credit for the foreign taxes against the United States tax if a consolidated return is filed.

California, however, is different. It adds the foreign source net income before taxes to the parent's income. California allows neither a deduction nor a credit for the taxes paid by the foreign operating subsidiary

to the host country. Hence the income California allocates to itself which has been taxed by the foreign country is taxed twice, once in the foreign, host country, and once in California. See Jurisdictional Statement pp. 9-12. This is the same burden which in Japan Lines v. County of Los Angeles, supra, 441 US 434, this Court held impermissible.

CONCLUSION

The California unitary combination of foreign affiliated corporations and corporate parents doing business in California, apportioned by a three-factor formula, taxes foreign income and requires submission to the State of California of information extraterritorial to that state and to the United States. The tax ultimately found subjects foreign income to multiple taxation, acts as an impermissible regulation of foreign commerce, and disturbs international relations

of the United States. For these reasons, it is in clear violation of the United States Constitution, Article I, Sec. 8, Cl. 3 (foreign commerce). For these reasons, jurisdiction of the appeal should be noted.

Respectfully submitted,

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